

REPORT OF EXAMINATION
OF THE
VETERINARY PET INSURANCE COMPANY
AS OF
DECEMBER 31, 2011

Filed September 26, 2012

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Los Angeles, California
July 23, 2012

Honorable Dave Jones
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

VETERINARY PET INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 1800 East Imperial Highway, Suite 145, Brea, California 92821.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was made as of December 31, 2007. This examination covers the period from January 1, 2008 through December 31, 2011. The examination was conducted in accordance with the National Association of Insurance Commissioners' Financial Condition Examiners' Handbook (Handbook). The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, to identify prospective risks, and to obtain information about the Company, including corporate governance, identification and assessment of inherent risks, and the evaluation of the system controls and procedures used to mitigate those risks. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an evaluation of the overall financial statement presentation, and management's compliance with Statutory Accounting Principles and Annual Statement instructions. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

The examination was a coordinated examination and was conducted concurrently with the examinations of the other insurance entities in the holding company group, including Nationwide Mutual Insurance Company, Scottsdale Insurance Company, and National Casualty Company. The Ohio and Wisconsin Departments of Insurance conducted the examinations of the other insurance entities.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: fidelity bonds and other insurance; pensions, stock ownership and insurance plans; growth of company; accounts and records; loss experience; statutory deposits; and sales and advertising.

COMPANY HISTORY

On June 8, 2005, Scottsdale Insurance Company (SIC), the Company's parent, advanced the Company \$15 million as a surplus note contribution. The note bore interest at a fixed rate of 5%, with semi-annual payments of interest only. The surplus note contribution was approved by the California Department of Insurance (CDI) on May 11, 2005. On December 7, 2009, with the CDI's approval, the surplus note of \$15 million and interest due of \$371,917 were converted to additional 1,113,907 shares of common stock at a price of \$13.80 per share.

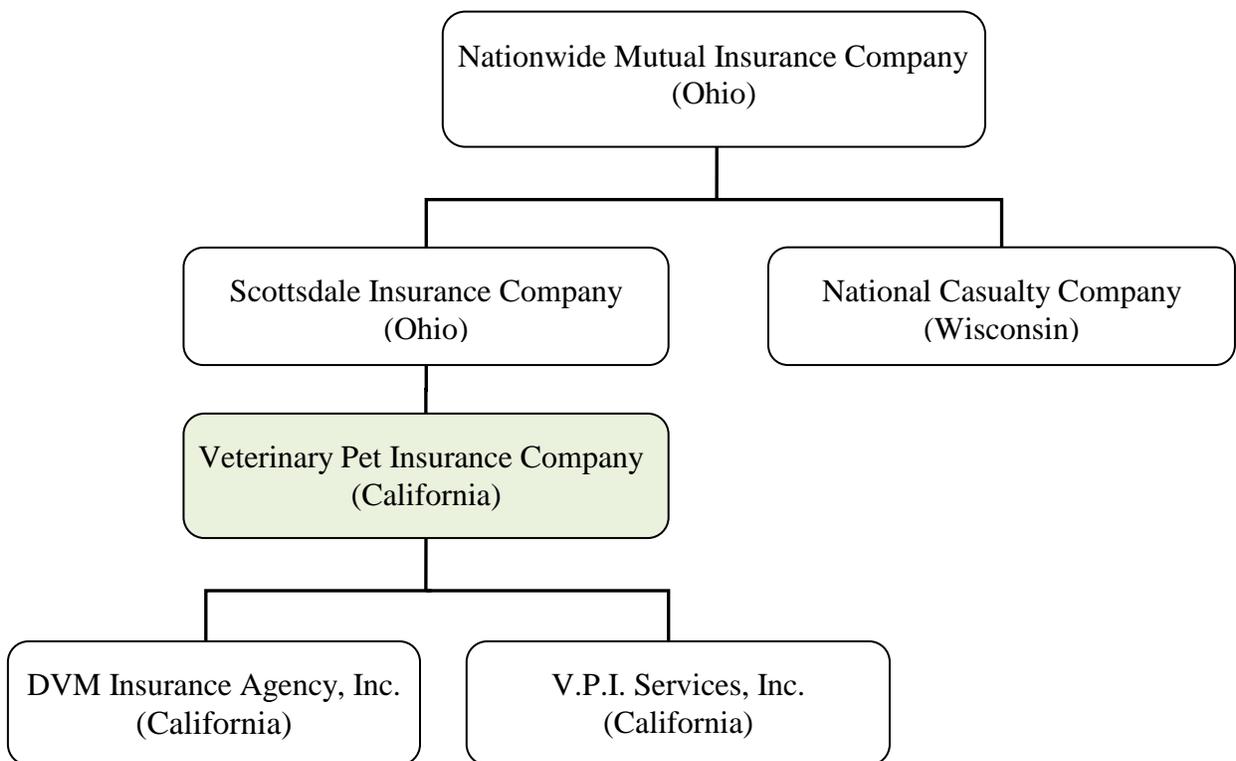
On May 1, 2008, SIC made a tender offer to purchase all of the Company's remaining outstanding shares for \$13.80 per share. At the time of the offer, the Company had 5,785,743 outstanding shares of common stocks, of which SIC owned 3,743,556 or 65% of the total shares. On December 10, 2008, SIC completed the purchase of the remaining shares and since then owns 100% of the Company.

During 2008, the Company's employees exercised their stock options, resulting in increases in the Company's common capital stock of \$12,690 and gross paid-in and contributed surplus of \$961,310.

On December 28, 2011, with the CDI's approval, the Company amended its certificate of authority to add Marine class of insurance.

MANAGEMENT AND CONTROL

The following abridged organizational chart, which is limited to the Company's ultimate parent along with its subsidiaries, depicts the Company's relationship within the holding company system as of December 31, 2011:



(*) All ownership is 100%.

Management of the Company is vested in a four-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2011 follows:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Mark W. Beres Lewis Center, Ohio	Vice President and Chief Executive Officer of Office of Administration Nationwide Mutual Insurance Company
Dennis P. Drent (*) Yorba Linda, California	President Veterinary Pet Insurance Company
Terri L. Hill Columbus, Ohio	Executive Vice President Nationwide Mutual Insurance Company
Michael D. Miller Scottsdale, Arizona	Executive Vice President Nationwide Mutual Insurance Company

Principal Officers

<u>Name</u>	<u>Title</u>
Dennis P. Drent (*)	President
Michael E. Funck	Vice President and Treasurer
Philippe E. Grevin	Vice President and General Counsel
Robert W. Horner, III	Vice President and Secretary
Jonathan E. Kass	Vice President and Chief Information Officer
Carol J. McConnell	Vice President and Chief Veterinary Medical Officer

(*) Resigned effective June 8, 2012 and was replaced by Scott Liles as President and Chief Pet Insurance Officer.

Management Agreements

Tax Sharing Agreement: The Company and its wholly-owned subsidiaries, DVM Insurance Agency, Inc. (DVM) and V.P.I. Services, Inc. (VPIS), participate in a Tax Sharing Agreement dated January 1, 2008 with its ultimate parent, Nationwide Mutual Insurance Company (NMIC). Pursuant to this agreement, NMIC prepares and files a consolidated federal tax return on behalf of the participants to this agreement and allocates tax liability for each participant based on separate return calculations.

Payment of tax liability is made within 90 days following the filing of the tax return. The California Department of Insurance (CDI) approved this agreement on December 15, 2008.

Administrative Services Agreement: The Company has an Administrative Services Agreement, effective December 31, 2008, with DVM. Pursuant to this agreement, the Company provides services to DVM including, but not limited to: financial reporting, tax compliance, treasury services, budget and cost accounting, personnel, human resources, insurance producer support services, payroll, electronic fund transfers, legal, office services, marketing and corporate affairs services, computer services, graphic arts, and additional services as needed. In return, DVM reimburses the Company with the 28.5% agency commission earned from National Casualty Company (NCC), an affiliate of the Company. DVM is NCC's licensed insurance agent that produces the Company's non-California business by selling non-California insurance policies issued by NCC. The services fee earned by the Company totaled \$46,599,892; \$43,626,697; and \$40,959,589 for 2011, 2010, and 2009, respectively. The intercompany balances related to this agreement are settled on a monthly basis. The CDI approved the agreement on January 15, 2009.

Administrative Services Agreement: The Company has an Administrative Services Agreement, effective December 31, 2008, with VPIS. The Company operates a nationwide pet registry and recovery service for its policyholders through VPIS that includes a pet identification and pet recovery program for lost pets. Pursuant to this agreement, the Company provides all administrative services including, but not limited to: financial reporting, tax compliance, treasury services, budget and cost accounting, personnel, human resources, insurance producer support services, payroll, electronic fund transfers, legal, office services, marketing and corporate affairs services, computer services, graphic arts, and additional services as needed. The Company receives all VPIS income in consideration for these services. The service fees earned by the Company aggregated \$2,482,944; \$3,377,032; and \$3,578,989 for 2011, 2010, and 2009, respectively. The intercompany balances related to this agreement are settled on a monthly basis. The CDI approved this agreement on January 15, 2009.

Second Amended and Restated Cost Sharing Agreement: The Company is a party to the Second

Amended and Restated Cost Sharing Agreement, effective January 1, 2011, with NMIC. Pursuant to this agreement, NMIC provides investment services to the Company. The Company paid NMIC investment service fees of \$102,011 for 2011. The CDI approved this agreement on February 4, 2011.

COPORATE RECORDS

California Insurance Code (CIC) Section 735 states that the Company must inform the board members of the receipt of the examination report. The board should be informed of the report both in the form first formally prepared by the examiners and in the form as finally settled and officially filed by the commissioner. The board must also enter that fact in the board minutes. A review of the board minutes disclosed that both the first formally prepared draft and the final report officially filed on April 3, 2009 were not presented to the board.

It is recommended that the Company implement procedures to ensure future compliance with CIC Section 735.

TERRITORY AND PLAN OF OPERATION

The Company provides individual medical and health insurance coverage for pets, mainly dogs and cats. The Company is licensed in California and Ohio, but writes direct business in California only. It assumes similar business outside California from Scottsdale Insurance Company (SIC) under a quota share agreement. The non-California business is produced by DVM Insurance Agency, Inc. and underwritten by National Casualty Company.

In 2011, the Company had net written premiums of \$219.8 million, of which, \$40.6 million were direct premiums and \$179.2 million were premiums assumed from SIC. The Company's main markets are individuals and groups for companies with at least 100 employees.

REINSURANCE

Assumed

DVM Insurance Agency, Inc. (DVM) produces pet insurance business outside California for National Casualty Company (NCC). NCC, in turn, reinsures 100% of this non-California business to Scottsdale Insurance Company (SIC) and receives all the ceding commission SIC obtains from the Company. The Company assumes the non-California business from SIC under a 100% Quota Share Agreement, effective January 1, 2011. The Company pays SIC a flat ceding commission rate of 31.5% of the net written premium ceded. The ceding commission of 31.5% is comprised of agency commission of 28.5% paid by NCC to DVM and premium tax and other expenses of 3% incurred by NCC.

As aforementioned in the Management Agreements section, the Company provides administrative and management services to DVM in connection with DVM's production of the non-California business for NCC. In return for its services, the Company is reimbursed by DVM with the 28.5 % commission DVM receives from NCC.

Ceded

The Company does not cede any reinsurance.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2011

Underwriting and Investment Exhibit for the Year Ended December 31, 2011

Reconciliation of Surplus as Regards Policyholders from December 31, 2007
through December 31, 2011

Statement of Financial Condition
as of December 31, 2011

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 131,716,887	\$	\$ 131,716,887	
Common stocks	(2,792,930)		(2,792,930)	
Cash and short-term investments	6,198,951		6,198,951	
Receivable for securities	1,142,313		1,142,313	
Investment income due and accrued	1,305,172		1,305,172	
Premiums and agents' balances in course of collection	2,474,250	372,033	2,102,217	
Premiums, agents' balances and installments booked but deferred and not yet due	66,415,852		66,415,852	
Net deferred tax asset	11,498,075	4,707,689	6,790,386	
Electronic data processing equipment and software	2,686,635	2,686,635		
Furniture and equipment, including health care delivery assets	4,934,910	4,934,910		
Receivables from parent, subsidiaries and affiliates	13,191,740		13,191,740	
Aggregate write-ins for other than invested assets	<u>2,769,886</u>	<u>2,455,078</u>	<u>314,808</u>	
 Total assets	 <u>\$ 241,541,741</u>	 <u>\$ 15,156,345</u>	 <u>\$ 226,385,396</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses and loss adjustment expenses			\$ 19,020,857	(1)
Reinsurance payable on paid loss and loss adjustment expenses			6,851,947	
Commissions payable, contingent commissions and other similar charges			323,760	
Other expenses			10,023,720	
Taxes, licenses and fees			98,075	
Current federal and foreign income taxes			6,067,350	
Unearned premiums			103,601,739	
Advance premiums			613,358	
Payable for securities			4,620,125	
Aggregate write-ins for liabilities			<u>760,396</u>	
 Total liabilities			 151,981,327	
Common capital stock		\$ 1,240,711		
Gross paid-in and contributed surplus		39,519,563		
Unassigned funds (surplus)		<u>33,643,795</u>		
Surplus as regards policyholders			<u>74,404,069</u>	
 Total liabilities, surplus and other funds			 <u>\$ 226,385,396</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2011

Statement of Income

Underwriting Income

Premiums earned		\$ 198,938,491
Deductions:		
Losses and loss expenses incurred	\$ 115,321,566	
Other underwriting expenses incurred	8,286,703	
Aggregate write-ins for underwriting deductions	<u>74,019,982</u>	
Total underwriting deductions		<u>197,628,251</u>
Net underwriting gain		1,310,240

Investment Income

Net investment income earned	\$ 4,725,689	
Net realized capital gain	<u>53,415</u>	
Net investment gain		4,779,104

Other Income

Finance and service charges not included in premiums	\$ 8,067,314	
Aggregate write-ins for miscellaneous income	<u>(148,295)</u>	
Total other income		<u>7,919,019</u>
Net income before federal income taxes		14,008,363
Federal income taxes incurred		<u>6,383,302</u>
Net income		<u>\$ 7,625,061</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2010		\$ 71,014,335
Net income	\$ 7,625,061	
Change in net deferred income tax	3,410,703	
Change in non-admitted assets	<u>(7,646,030)</u>	
Change in surplus as regards policyholders for the year		<u>3,389,734</u>
Surplus as regards policyholders, December 31, 2011		<u>\$ 74,404,069</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2007 through December 31, 2011

Surplus as regards policyholders,
 December 31, 2007 per Examination \$ 35,699,103

	Gain in Surplus	Loss in Surplus
Net income	\$ 39,879,297	\$
Change in net deferred income tax	4,177,161	
Change in non-admitted assets		6,249,372
Change in surplus note		15,000,000
Paid-in capital	210,142	
Surplus paid-in	16,135,775	
Aggregate write-ins for gains and losses in surplus		448,037
Total gains and losses	\$ 60,402,375	\$ 21,697,409

Net increase in surplus as regards policyholders 38,704,966

Surplus as regards policyholders,
 December 31, 2011, per Examination \$ 74,404,069

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The Company's reserves were evaluated by a Casualty Actuary from the California Department of Insurance. Based on the analysis, the Company's December 31, 2011 reserves for losses and loss adjustment expenses appear reasonable and have been accepted for purposes of this examination report.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Corporate Records (Page 6): It is recommended that the Company implement procedures to ensure future compliance with CIC Section 735.

Previous Report of Examination

Comments on Financial Statement Items – Receivable from Parent, Subsidiaries and Affiliates and Reinsurance Payable on Paid Losses and Loss Adjustment Expenses (Page 11): It was recommended the Company report the balance for reinsurance payable separately in accordance with Statement of Statutory Accounting Principles No. 62, paragraph 42. The Company has complied with this recommendation.

ACKNOWLEDGEMENT

Acknowledgement is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

_____/S/_____
Tony L. Tran, CFE
Examiner-In-Charge
Senior Insurance Examiner (Specialist)
Department of Insurance
State of California